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SUBJECT: Austria Economic Outlook - Bottom Reached, Modest Growth in 2010

REF: (A) VIENNA 0856; (B) VIENNA 1081

¶1. SUMMARY: Austria's economy will post a deep recession for 2009, but economists expect stabilization in the second half and are increasingly optimistic for 2010 (growth of 1.0%). Government stimulus must continue in order not to stifle the weak recovery. Pressure on the labor market will persist, unemployment will rise to 5.0-5.3% in 2009 and 5.8% in 2010. Inflation is not on the horizon. The GoA's large stimulus will push the budget deficit to 4.5%/GDP in 2009 and 5.5%/GDP in 2010. Economists want the GoA to develop a roadmap to cut the deficit and reduce Austria's public debt level after the crisis. END SUMMARY.

Economy Reached the Bottom in Q3/2009

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¶2. After Austria's worst recession since WWII, the economy seems to have bottomed out in Q3/2009 and is starting to recover according to WIFO (Austrian Institute for Economic Research) Director Karl Aigner and IHS (Institute for Advanced Studies) Director Bernhard Felderer. Aigner and Felderer warned that the recovery will be slow and bumpy. WIFO stands by its projection for GDP to shrink by 3.4% in 2009, while IHS foresees -3.8% in 2009 (revised from -4.3% three months ago).

¶3. Forecasts for full-year 2009 are for exports of goods to drop 14-15% (real terms), imports by 11-12%, investment by 8-11%, private consumption is projected grow by 0.2-0.3% and public consumption by 0.8-1.0%. Neither inflation nor deflation are on the horizon. As a result of the GoA's income tax cut, real per capita after-tax net incomes will rise 3.0% in 2009, but will be partly offset by shrinking employment. The savings rate will reach around 12.7% of disposable income in 2009.

Modest Growth in 2010 and Beyond

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¶4. IHS and WIFO no longer expect stagnation in 2010. Exports will grow again in 2010 (due to worldwide stimulus measures) after a sharp contraction in 2009. Imports will grow at a lower rate, making Austria's current account balance positive again. Investment (at least replacement investment) is expected to increase based on improved financing conditions and tax breaks, but continued overcapacity will make industry reluctant to make new investments. Private consumption will grow (0.5%) and provide continued stimulus

along with public consumption. Economists do not expect a significantly higher economic growth rate in 2011 or 2012.

¶15. While the crisis of production and output will be "over" in 2010, unemployment is expected to keep rising through late 2010) along with the GoA deficit (which will be even higher next year) and public debt level, which will keep rising beyond 2010. Aiginger and Felderer stressed the continued important role of economic stimulus -- Austria's recovery is not yet self-supporting -- urging the GoA to fully implement legislated measures and warning that an early end to stimulus measures could destroy the weak recovery.

Underlying Assumptions

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¶16. The institutes based their revised 2009/2010 forecasts on the following assumptions:

	2009	2010
U.S. economic growth	-2.7%	1.0-1.7%
Eurozone growth	c.-4.0%	.6-1.0%
EU-27 growth	c.-4.0%	.8-1.0%
German growth	-5.0%	1.0-1.2%
oil price (barrel)	\$60-61	\$75-80
USD/Euro	.71-.72	.67-.74.

Labor Market - No Turn-Around in Sight

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¶17. Since the beginning of the year, the number of unemployed has risen strongly. In August 2009, the number of employed was 2.0% below the comparable 2008 figure. According to Aiginger and Felderer, the employment decline has not yet reached the bottom and will continue for several more months; unemployment will continue to rise in 2010 - it usually peaks 1.5-2 years after an economic crisis begins. In 2009, economists project employment to shrink 1.5% and the number of unemployed to rise by close to 30% or 55,000-60,000 for an annual average of around 270,000 (2008: 212,000). For 2010, the institutes project employment to shrink 1.0% and the number of unemployed to rise by 13% or 30,000 for an annual average of 303,000-306,000. The projected unemployment rates are 5.0-5.3% in 2009 and 5.8% in 2010, with not much relief expected in 2011. In addition to those included in the unemployment statistics, Austria will have an additional 100,000 workers on reduced working hours or in training.

Budget Deficit: 4.5%/GDP in 2009, 5.5% in 2010

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¶18. The cost of large GoA stimulus measures, bank rescue package, and automatic stabilizers lead WIFO and IHS to project a total public sector deficit of 4.5% in 2009 and 5.4-5.7% in 2010. These deficits will bring the total public sector debt to around 75%/GDP by 2010 and 80%/GDP by 2011. Economists concur on the need to reduce the debt level after the crisis but say that the economy will be too weak in 2010 to begin consolidation. Aiginger and Felderer urged the GoA to set out an austerity roadmap concentrating on expenditures (because spending cuts are more effective and long-lasting than revenue measures). Given Austria's already high tax quota, revenue increases should be the last resort. The ECB's strong price stability anchor means that inflation will not help much to reduce public debt.

¶19. COMMENT: Given the size of the deficit and a debt repayment requirement of around EUR 60 billion (to reduce the public debt level from 80%/GDP to 60%/GDP) we are not optimistic that the GoA will be able to consolidate without tax increases. END COMMENT.

¶10. Statistical Annex

Projections of Austrian Economic Indicators (percent change from previous year, unless otherwise stated)

WIFO 2009	IHS 2009	WIFO 2010	IHS 2010
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Real terms:

GDP	-3.4	-3.8	1.0	1.0
Manufacturing	-9.5	n/a	1.5	n/a
Private consumption	0.2	0.3	0.5	0.5
Public consumption	0.8	1.0	1.5	0.8
Investment	-8.0	-10.8	-0.1	-0.2
Exports of goods	-15.1	-16.0	2.0	4.5
Imports of goods	-11.2	-13.5	2.0	3.5

Nominal Euro billion equivalents:

GDP	277.6	275.2	282.7	280.7
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OTHER INDICES:

GDP deflator	1.9	1.5	0.9	1.0
Consumer prices	0.5	0.6	1.3	1.4
Unemployment rate	5.3	5.0	5.8	5.8
Current account (in percent of GDP)	1.9	n/a	1.9	n/a
Exchange rate (US\$ / Euro)	0.71	0.72	0.67	0.74

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